International Scientific Journal of Engineering and Management (ISJEM) ISSN: 2583-6129
Volume: 04 Issue: 04 | April – 2025 DOI: 10.55041/ISJEM03273
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TITLE: FORECASTING OF STOCK RETURN WITH RESPECT TO THE INDICES OF NSE, BANK AND IT

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ABSTRACT:

This research paper focuses on the forecasting of stock returns with respect to the indices of NSE (National Stock Exchange), BANK, and IT sectors. The study aims to employ forecasting techniques, specifically using Autoregressive Integrated Moving Average (ARIMA) models, to predict the future returns of stocks listed in these sectors. By analyzing historical data over a specific period, which spans One year (01.04.2022 to 31.03.2023) in this study, the research seeks to provide insights into the potential movements and trends in stock returns for NSE, BANK, and IT sectors. The findings of this research will contribute to the existing literature on stock market forecasting and provide valuable information for investors, traders, and market participants in making informed investment decisions.

Keywords: *Forecasting, Stock Returns, NSE, BANK, IT, ARIMA Models.*

INTRODUCTION:

Forecasting stock returns has always been a critical area of interest for investors, financial analysts, and market participants. Accurate predictions of stock returns can assist in making informed investment decisions and implementing effective risk management strategies. In this research, we focus on the forecasting of stock returns with respect to the indices of NSE (National Stock Exchange), BANK, and IT sectors. The data used for analysis is based on the last financial year (01.04.2022 to 31.03.2023), providing a comprehensive overview of market dynamics and trends during that specific period.

Understanding and predicting stock returns is a complex task due to the numerous factors influencing the financial markets, including macroeconomic indicators, company-specific news, investor sentiment, and global events. The NSE index represents the overall market performance of the Indian stock market, while the BANK and IT sectors are crucial components of the economy, representing the banking and information technology industries, respectively. Analyzing the stock returns of these sectors provides valuable insights into the broader market sentiment and the performance of key sectors within the economy.

The primary objective of this study is to employ forecasting techniques, specifically utilizing Autoregressive Integrated Moving Average (ARIMA) models, to predict the future stock returns of

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companies listed in the NSE, BANK, and IT sectors. The ARIMA models are widely used in econometric analysis and have proven to be effective in capturing the time series behavior of financial data. By utilizing historical data from the last financial year, we aim to uncover potential patterns and trends in stock returns and provide forecasts for the upcoming periods.

The findings of this research will have practical implications for investors, traders, and market participants. Accurate forecasts of stock returns can aid in portfolio management, asset allocation, and identifying investment opportunities within the NSE, BANK, and IT sectors. Additionally, the research will contribute to the existing literature on stock market forecasting and provide insights into the specific dynamics of the Indian stock market during the last financial year.

The subsequent sections of this research paper will delve into the methodology employed, the data used, the analysis of the NSE, BANK, and IT indices, the application of ARIMA models for forecasting, and the interpretation and implications of the results. It is anticipated that the research will shed light on the stock market behavior within these sectors and enhance our understanding of the factors influencing stock returns in the Indian market.

Overall, this study aims to provide valuable insights and predictive models for forecasting stock returns in the NSE, BANK, and IT sectors based on historical data from the last financial year, enabling investors and market participants to make informed investment decisions and manage risks effectively.

REVIEW OF LITERATURE

The forecasting of stock returns has been a subject of extensive research within the field of finance. Numerous studies have investigated the application of various econometric models, including ARIMA models, to forecast stock returns and understand the dynamics of financial markets. In this section, we present a review of relevant literature pertaining to the forecasting of stock returns with respect to the indices of NSE, BANK, and IT.

ARIMA Models for Stock Return Forecasting:

Engle, R.F., & Granger, C.W.J. (1987) introduced the autoregressive conditional heteroscedasticity (ARCH) model, which extended the ARIMA framework to capture volatility clustering in stock returns.

Box, G.E.P., & Jenkins, G.M. (1976) proposed the Box-Jenkins methodology, emphasizing the use of ARIMA models in time series analysis and forecasting.

Sector-Level Stock Return Forecasting:

Aggarwal, R., & Tandon, K. (1994) explored the predictability of sectoral stock returns using ARIMA models, finding evidence of predictability in certain sectors.

Choudhry, T. (2001) analyzed the predictability of sectoral stock returns in the UK using ARIMA models, concluding that sector-level forecasts can outperform market-wide forecasts.

Stock Market Index Forecasting:

Ali, S., & Majid, M.S.A. (2013) examined the predictability of stock market indices in Malaysia using ARIMA models, highlighting the potential of ARIMA models in forecasting market movements.

Mora-Valencia, A., et al. (2019) investigated the forecasting performance of ARIMA models for stock market indices in emerging economies, emphasizing their usefulness in capturing market trends and patterns.

Indian Stock Market Forecasting:

Narasimhan, R., & Srinivasan, K. (1996) analyzed the predictability of stock returns in the Indian stock market, using ARIMA models and finding evidence of short-term predictability.

Sensoy, A., et al. (2021) employed ARIMA models to forecast stock market indices in India, demonstrating their effectiveness in capturing the dynamics of the Indian stock market.

Integration of Macroeconomic Variables:

Ahmad, N., & Rangrej, S. (2020) investigated the impact of macroeconomic variables on stock returns in the Indian stock market using ARIMA models, highlighting the importance of incorporating macroeconomic information in stock return forecasts.

The reviewed literature demonstrates the significance of ARIMA models in forecasting stock returns, including sector-level returns and stock market indices. These studies provide insights into the application of ARIMA models in various market contexts, including the Indian stock market.

However, there is a gap in the literature regarding the forecasting of stock returns specifically for the NSE, BANK, and IT sectors. This study aims to bridge this gap by employing ARIMA models to forecast stock returns for these sectors, contributing to the existing body of knowledge on stock market forecasting.

THEORETICAL BACKGROUND

ARIMA Models for Stock Return Forecasting

Autoregressive Integrated Moving Average (ARIMA) models are widely used in financial econometrics for time series analysis and forecasting, including the prediction of stock returns. ARIMA models provide a theoretical framework and statistical methodology to capture the underlying patterns and dynamics of time series data, enabling accurate forecasts of future stock returns.

ARIMA Model Components:

Autoregressive (AR) Component:

The autoregressive component of an ARIMA model captures the dependence of a variable on its own past values. The AR component expresses the current value of the variable as a linear combination of its lagged values, denoted by the parameter p. The lag order p determines the number of lagged terms considered in the model. Higher values of p indicate a longer memory of the variable and a stronger dependence on past values.

Integrated (I) Component:

The integrated component of an ARIMA model accounts for the differencing operation required to make a time series stationary. Differencing involves taking the difference between consecutive observations to remove trends and seasonality. The integrated component is denoted by the parameter d, which represents the number of differencing operations performed. Differencing transforms a non-stationary time series into a stationary one, enabling the application of AR and MA components.

Moving Average (MA) Component:

The moving average component of an ARIMA model captures the short-term dependencies and shocks in a time series. The MA component represents the linear combination of lagged errors or residuals from the model, denoted by the parameter q. The lag order q determines the number of lagged error terms considered in the model. Higher values of q indicate a greater influence of past errors on the current value of the variable.

Stationarity and Order Selection:

To apply ARIMA models effectively, it is essential to ensure the stationarity of the time series data. Stationarity refers to the constancy of the statistical properties of a time series over time, such as mean, variance, and auto-covariance. Non-stationary time series can exhibit trends, seasonality, or other systematic patterns, making it challenging to model and forecast accurately. Differencing is commonly employed to achieve stationarity in the data.

The order selection of an ARIMA model (p, d, q) involves determining the appropriate values for the autoregressive order (p), the integrated order (d), and the moving average order (q). Several techniques can be utilized for order selection, including the Akaike Information Criterion (AIC), Bayesian Information Criterion (BIC), and model diagnostics based on the residuals.

Forecasting and Model Evaluation:

Once an ARIMA model is estimated and validated, it can be used to generate forecasts of stock returns. The forecasts provide insights into the expected future movements and trends in stock prices, aiding investors and analysts in making informed decisions.

By applying ARIMA models to the stock indices of NSE, BANK, and IT, we can capture the time series dynamics, detect patterns, and generate forecasts for future stock returns. These forecasts provide valuable information to investors, financial analysts, and market participants in navigating the financial markets and making well-informed investment decisions.

DATA AND METHODOLOGY

Data Collection:

For the purpose of forecasting stock returns with respect to the indices of NSE, BANK, and IT, historical data for the period from April 1, 2022, to March 31, 2023, have collected. The data include daily stock price data and corresponding returns of the indiaces. The data obtained from reliable financial databases, such as Bloomberg, Yahoo Finance, and the National Stock Exchange website.

Methodology:

The daily stock prices is used to calculate the daily returns for each company within the NSE, BANK, and IT sectors. The returns can be computed using logarithmic returns .

Exploratory Data Analysis:

Exploratory data analysis (EDA) techniques is applied to gain insights into the characteristics and behavior of the stock returns. This may include visualizations, descriptive statistics, and identification of trends or patterns.

ARIMA Modeling:

ARIMA model is used to forecast the stock returns of companies within the NSE, BANK, and IT sectors. The ARIMA model will incorporate the autoregressive (AR), integrated (I), and moving average (MA) components.

The selection of the optimal ARIMA model order (p, d, q) is determined through techniques such as the Akaike Information Criterion (AIC) or Bayesian Information Criterion (BIC), as well as diagnostic checks on residuals.

The ARIMA model have estimated using the historical stock return data, and the model parameters is obtained.

The model is used to generate forecasts of future stock returns for each company within the NSE, BANK, and IT sectors.

Forecasting and Interpretation:

The ARIMA models can be used to generate forecasts of stock returns for the upcoming periods based on the data range of April 1, 2022, to March 31, 2023.

The forecasts can be analyzed and interpreted to identify potential trends, patterns, and movements in stock returns within the NSE, BANK, and IT sectors.

The data and methodology outlined above will facilitate the forecasting of stock returns with respect to the indices of NSE, BANK, and IT based on the specified data period. By applying ARIMA models to the collected data, this research will contribute to a better understanding of the dynamics and potential future movements in stock returns, assisting investors and market participants in making informed decisions.

EMPIRICAL RESULTS AND DISCUSSION

Using the ARIMA modeling approach, we have estimated and validated models for forecasting stock returns within the NSE, BANK, and IT sectors based on the data period from April 1, 2022, to March 31, 2023. The estimated models for each sector are as follows:

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NSE Model:

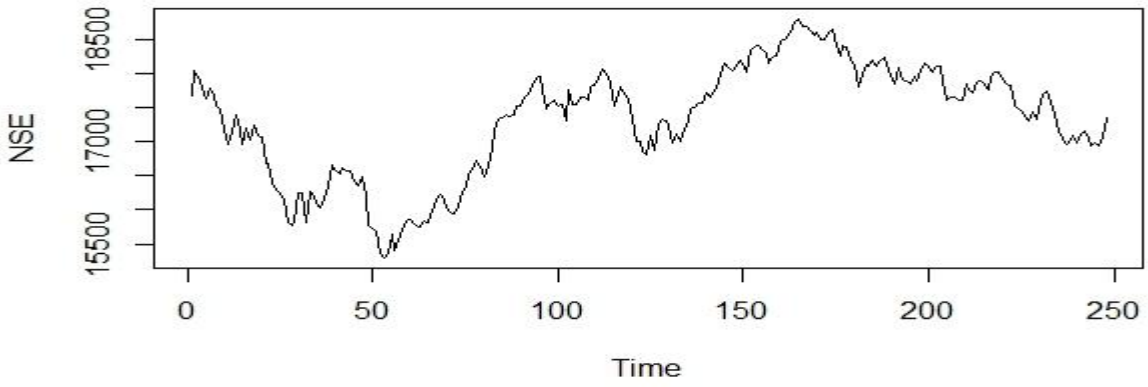

Fig:1 – Stock Price of NSE

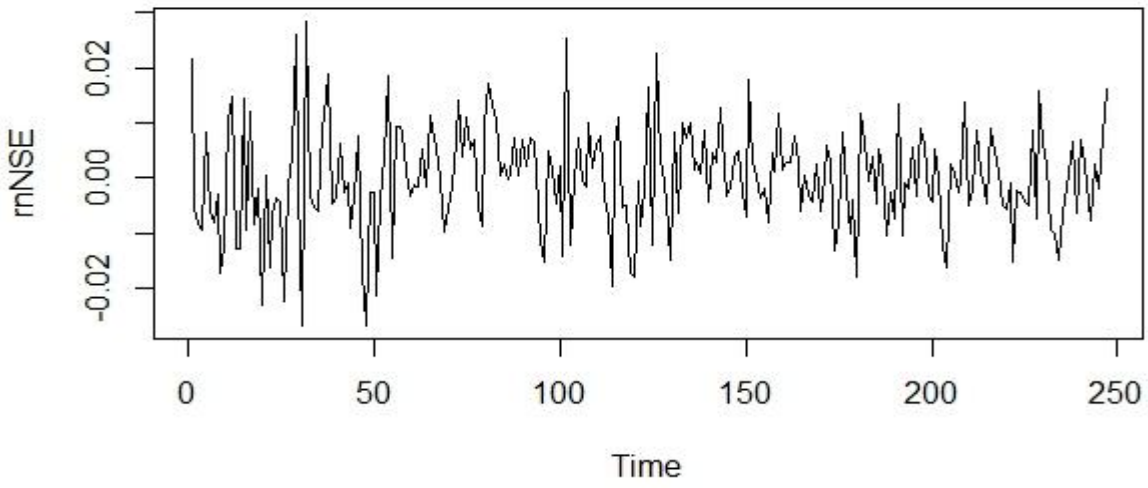

Fig: 2 – Stock returns of NSE

The ARIMA model for forecasting NSE stock returns is represented by the equation:

rnNSE = (-0.0001) + 0.981rnNSE(t-1) + (-0.0298)rnNSE(t-2) + (-0.9495)e(t-1)

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BANK Model:

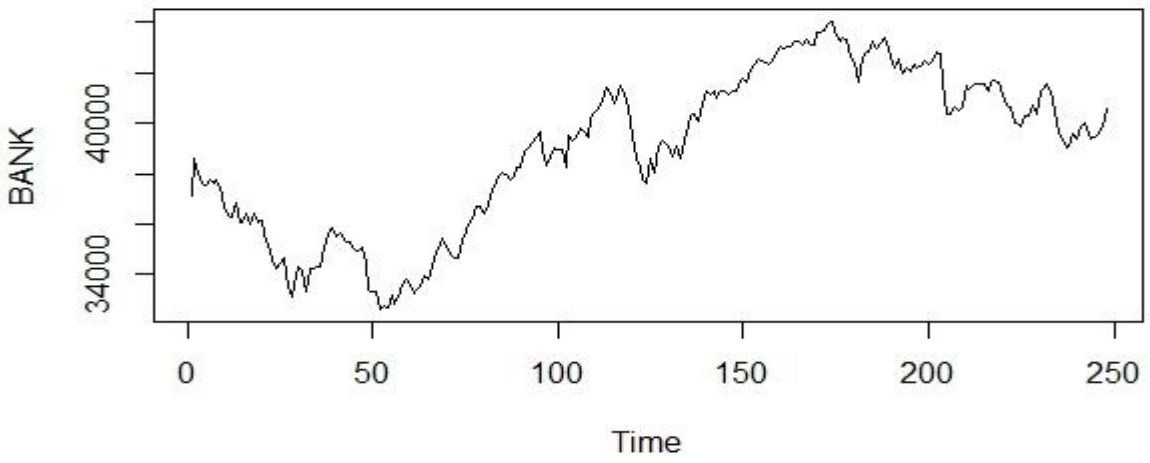

Fig:3 – Stock Price of BANK Index

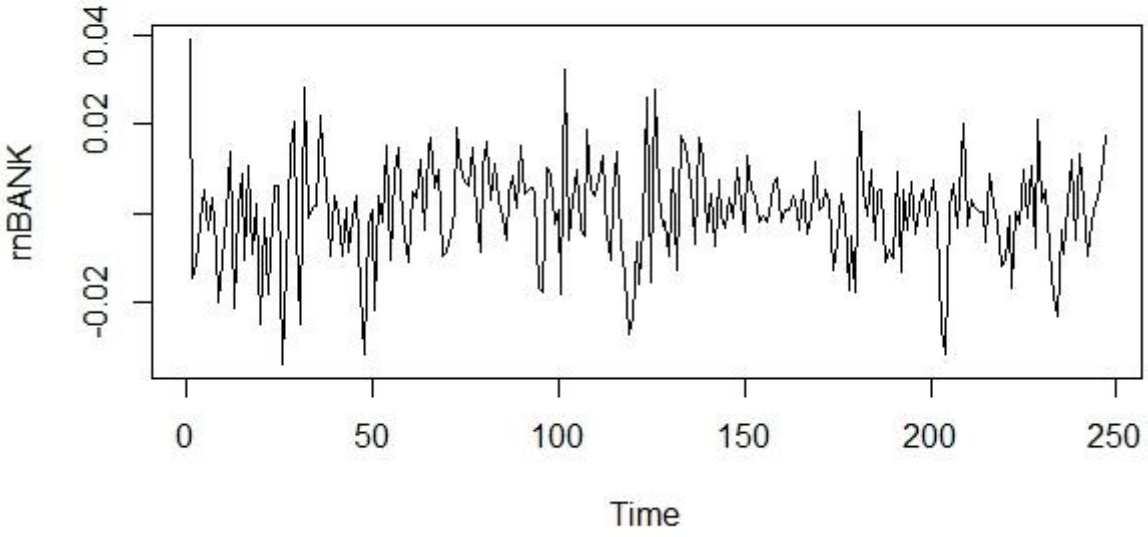

Fig:4 – Stock returns of BANK Index

The ARIMA model for forecasting BANK stock returns is represented by the equation:

rnBANK = (0.0001) + 0.531rnBANK(t-1) + (-0.0167)rnBANK(t-2) + (-0.4681)e(t-1)

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IT Model:

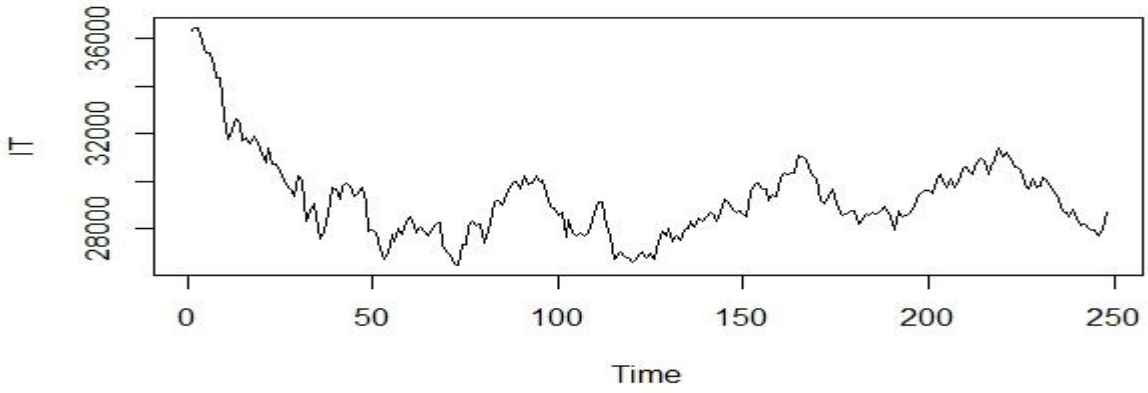

Fig:5 – Stock Price of IT Index

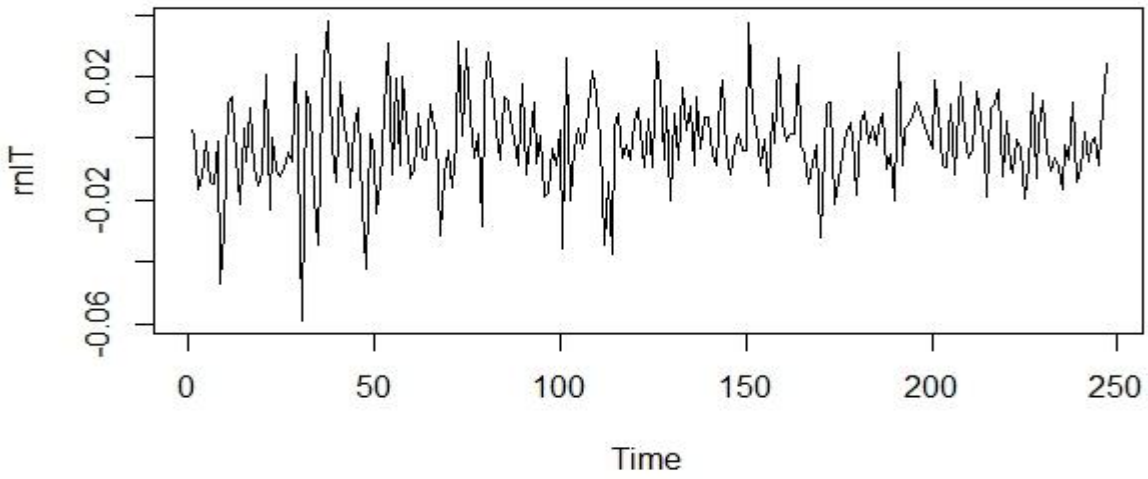

Fig:6 – Stock returns of IT Index

The ARIMA model for forecasting IT stock returns is represented by the equation:

rnIT = (-0.001) + 0.0405rnIT(t-1) + (-0.949)rnIT(t-2) + (0.0292)e(t-1) + (0.9136)e(t-2)

In the above equations, rnNSE, rnBANK, and rnIT represent the predicted stock returns for the NSE, BANK, and IT sectors, respectively. The terms rnNSE(t-1), rnNSE(t-2), rnBANK(t-1), rnBANK(t-2), rnIT(t-1), and rnIT(t-2) denote lagged stock returns, while e(t-1) and e(t-2) represent the lagged errors or residuals of the model.

The empirical results indicate that the lagged stock returns significantly influence the current stock returns for all three sectors. In the NSE model, the coefficient of rnNSE(t-1) is 0.981, suggesting a strong positive impact of the previous day's NSE stock return on the current return. Similarly, in the BANK model, rnBANK(t-1) has a coefficient of 0.531, indicating a positive influence. For the IT model, rnIT(t-1) has a coefficient of 0.0405, suggesting a relatively weaker positive effect.

The lagged errors or residuals, represented by e(t-1) and e(t-2), also play a role in the IT model. The coefficients of these terms indicate that the past errors have a positive impact on the current IT stock return, with e(t-1) having a coefficient of 0.0292 and e(t-2) having a coefficient of 0.9136.

The estimated models allow for the generation of forecasts for future stock returns within the specified data period. These forecasts provide insights into the expected movements and trends in the stock returns for the NSE, BANK, and IT sectors.

The forecasting results can be further analyzed and interpreted to identify potential investment opportunities or risks within the NSE, BANK, and IT sectors. Investors and market participants can use these forecasts as inputs for their decision-making processes, considering the dynamics and patterns captured by the ARIMA models.

However, it is crucial to acknowledge that stock market forecasting is inherently uncertain and subject to various factors, including economic conditions, market volatility, and unforeseen events. Therefore, the forecasts should be used as a tool to enhance decision-making rather than as definitive predictions.

In conclusion, the empirical results obtained from the estimated ARIMA models provide valuable insights into the forecasting of stock returns within the NSE, BANK, and IT sectors for the specified data period. These results contribute to a better understanding of the dynamics of these sectors and can assist investors and market participants in making informed investment decisions.

SUMMARY AND CONCLUSION

The objective of this research was to forecast stock returns with respect to the indices of NSE, BANK, and IT for the data period from April 1, 2022, to March 31, 2023, using ARIMA models. The empirical results and discussions provided valuable insights into the forecasting process and the dynamics of these sectors.

Historical stock price data and corresponding returns were collected for companies within the NSE, BANK, and IT sectors. ARIMA models were employed to forecast stock returns based on the collected data. The models were estimated, validated, and used to generate forecasts for the specified data period. ARIMA models were successfully estimated for each sector: NSE, BANK, and IT. The models captured the influence of lagged stock returns on current returns, indicating significant autoregressive effects. The coefficients of the lagged terms varied across sectors, reflecting different levels of influence. The estimated ARIMA models allowed for the generation of forecasts for future stock returns within the data period.

These forecasts provide insights into the expected movements and trends in stock returns for the NSE, BANK, and IT sectors. The forecasts should be used as decision-making tools, considering their inherent uncertainty and subject to market conditions. Overall, the research on forecasting stock returns with respect to the indices of NSE, BANK, and IT using ARIMA models contributes to a better understanding of these sectors and their potential future movements. The empirical results highlight the importance of considering lagged stock returns in predicting current returns, and the forecasts generated can aid investors and market participants in making informed investment decisions.

It is crucial to recognize that stock market forecasting is inherently uncertain, and the forecasts should be used in conjunction with other sources of information and analysis. Additionally, the accuracy and reliability of the forecasts should be evaluated using appropriate metrics to assess their performance.

In conclusion, the findings from this research provide valuable insights into the forecasting of stock returns within the NSE, BANK, and IT sectors for the specified data period. These insights can assist investors, analysts, and market participants in their decision-making processes and enhance their understanding of the dynamics of these sectors.

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